Office Supreme Court, U.S.
FILED
JUL 31 1981
ALEXANDER L. STEVAS,
CLERK

No. 80-1251

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1980.

UNITED STATES OF AMERICA,

Petitioner,

v.

VOGEL FERTILIZER COMPANY,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR AMICI CURIAE DIXIE REALTY COMPANY, INC. and DIXIE FURNITURE CO., INC. IN SUPPORT OF VOGEL FERTILIZER COMPANY, Respondent

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BRIEF FOR AMICI CURIAE DIXIE REALTY COMPANY, INC. and DIXIE FURNITURE CO., INC. IN SUPPORT OF VOGEL FERTILIZER COMPANY, Respondent

This brief is submitted on behalf of Dixie Realty Company, Inc. and Dixie Furniture Co., Inc., as *amici curiae*, in support of Respondent Vogel Fertilizer Company pursuant to Rule 36 of this Court by written consent of all the parties to the case.[1]

[1] Copies of letters dated July 6, 1981, and July 7, 1981, from counsel representing the parties in this case consenting to the filing by Dixie Realty Company, Inc. and Dixie Furniture Co., Inc., as

[footnote continued]

Section 1561(a)(1) of the Internal Revenue Code of 1954 (I.R.C. §1561(a)(1)), provides that a controlled group of corporations shall be limited to one surtax exemption under Section 11(d). Section 1563(a)(2) provides a two-pronged test of stock ownership – an 80% test and a 50% test – in order to determine whether two or more corporations which are related by certain stock ownership interests of their shareholders constitute a brother-sister controlled group of corporations. In interpreting Section 1563, the Treasury has promulgated in Treasury Regulation §1.1563-1(a)(3) (1969) that for purposes of the 80% test, while the group of shareholders of five or fewer persons must, in the aggregate, own at least 80% of each of the corporations constituting the controlled group, each of the same such persons in the ownership group are not required to own stock in each corporate member of the group.

Petitioner seeks to reverse the decision of the Court of Claims which invalidated Treasury Regulation §1.1563-1 (a)(3) on the basis that it was "clearly inconsistent with the legislative history and unreasonable when the purpose as well as the bare words of the statute [Section 1563(a) (2) of the Internal Revenue Code of 1954 (26 U.S.C.)] are considered." (Pet. App. 12a). The Court of Claims concluded that a person must own stock in each entity of the brother-sister controlled group in order for a person's stock ownership to be taken into account for purposes of the 80% test of Section 1563(a)(2)(A).

INTEREST OF THE AMICI CURIAE

Dixie Realty Company, Inc. ("Dixie Realty"), an Arkansas corporation engaged in the business of owning

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amici curiae, have been presented and filed with the Court within the time for filing the brief of the Respondent.

and leasing real property, and Dixie Furniture Co., Inc. ("Dixie Furniture"), an Arkansas corporation engaged in the retail sale of furniture, filed a timely appeal in the United States Court of Appeals for the Eighth Circuit (No. 80-2183) from a decision of the United States Tax Court (*Dixie Realty Company, Inc. v. Commissioner*, T.C. Memo 1980-287, 40 T.C.M. (C.C.H.) 868 (1980)), which upheld the determination by the Commissioner of Internal Revenue of a deficiency assessed against Dixie Realty and Dixie Furniture on the basis that they were members of a "brother-sister" controlled group of corporations under Section 1563(a)(2) of the Internal Revenue Code.[2]

The question presented for resolution in *Dixie Realty Company, Inc. v. Commissioner*, No. 80-2183 (8th Cir., filed December 18, 1980) is identical to that presented to the Court in this case. The question to be decided is whether it is a requirement of Section 1563(a)(2) of the Internal Revenue Code of 1954, defining "brother-sister" controlled groups, that a stockholder own stock in *each* corporation of the group before his stock may be counted for purposes of the 80% test of Section 1563(a)(2)(A)

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[2] Although the Tax Court did not agree with the Commissioner of Internal Revenue on the validity of its interpretation of Section 1563(a)(2) (having previously ruled in favor of the taxpayer and holding Treas. Reg. §1.1561-1(a)(3) (1969) to be unlawful in Fairfax Auto Parts of Northern Virginia, Inc. v. Commissioner, 65 T.C. 798 (1976), *rev'd and remanded*, 548 F.2d 501 (4th Cir. 1977), *cert. denied*, 434 U.S. 904 (1977)), it decided in favor of the Treasury because it was "constrained" under the authority of Golsen v. Commissioner, 54 T.C. 742 (1970), *aff'd*, 445 F.2d 985 (10th Cir. 1971), *cert. denied*, 404 U.S. 940 (1971), to follow the Eighth Circuit Court's earlier decision on the same issues in T.L. Hunt, Inc. v. Commissioner, 562 F.2d 532 (8th Cir. 1977).

or whether the statute is met by a "5 or fewer" persons who own stock "singly or in combination" as set forth in the governing Treasury regulation.[3]

Following the filing of the petition for writ of certiorari to the Court of Claims by the United States in this case, Dixie Realty and Dixie Furniture filed a Consent Motion to Stay Proceedings and Briefing Schedule pending a determination of whether the Court would grant the petition for a writ of certiorari of the United States in this case. The United States Court of Appeals for the Eighth Circuit denied the Motion and briefs were filed by the parties. Contemporaneous with the filing of its Reply Brief on May 11, 1981, Dixie Realty and Dixie Furniture filed a Renewed Motion for Stay of Proceedings or, In the Alternative, To Waive Oral Argument and for an Expedited Decision in light of the granting of the petition for writ of certiorari in this case, which renewed motion was granted by the United States Court of Appeals for the Eighth Circuit on June 5, 1981.

The decision of the Court of Claims and review by the Court has immediate and substantial impact on Dixie Realty and Dixie Furniture. Dixie Realty and Dixie Furniture believe that their analysis of the important aspects of the statute, legislative history and legislative purpose critical to determination of the question presented for review will be of material aid to the Court.

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[3]The identical issue is also before this Court in Delta Metalforming Co. v. Commissioner, 632 F.2d 442 (5th Cir. 1980), *petition for cert. pending*, No. 80-1499 (filed Mar. 4, 1981), as well as before the Ninth Circuit in Baloaian v. Commissioner, Nos. 78-2438 and 78-2508, and before the Sixth Circuit in Davidson Chevrolet Co. v. Commissioner, No. 80-1041.

SUMMARY OF ARGUMENT

The Treasury's interpretation of Section 1563(a)(2)(A), Internal Revenue Code of 1954 (IRC §1563(a)) as set forth in Treasury Regulation §1.1563-1(a)(3) (1969) is not supported by a plain meaning of the language of the statute or by an analysis of the legislative history and of the Congressional intent in adopting the statute and, therefore, the rule of deference normally accorded the Commissioner of Internal Revenue in interpreting the tax laws is inapplicable. Moreover "weighty reasons" are present in this case compelling that the Court not apply the normal rule of deference. The legislative history of Section 1563(a)(2)(A) of the Internal Revenue Code of 1954 clearly does not support the Commissioner's interpretation that the statute is satisfied if "five or fewer persons" own stock "singly or in combination." Rather, the legislative history mandates that for the purpose of the 80% test, "five or fewer persons" must own stock in *each* corporation of the group before the shareholders can be counted for the purpose of the 80% test.

A careful examination of the Treasury's addition of the words "singly or in combination" to the statute of Treasury Regulation §1.1563-1(a)(3) distorts the intent of Congress. In this respect, the statute is definitional and constitutes a decision by Congress to replace the prior subjective standard with an objective test. The Commissioner should not and does not have the authority to legally expand the definitional standard established by Congress.

An examination of the legislative history to the 1969 Amendment of Section 1563(a)(2) confirms that the 80% test, contrary to the effect of the Treasury's regulation, was intended to be meaningful, and the 50% test was

created as a limitation of the 80% common ownership requirement. Examination of the Treasury's GENERAL EXPLANATION OF TREASURY TAX REFORM PROPOSALS BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS, 91st Cong., 1st Sess., Pt. 14, at 5394 (1969), shows that the purpose of the 1969 change was to increase the number of shareholders who could comprise the controlled group from one to five. Further, the Treasury's TECHNICAL EXPLANATION OF TREASURY TAX REFORM PROPOSALS BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS, 91st Cong., 1st Sess., Pt. 14, at 9162 (1969), demonstrates that the *same* persons were expected to comprise the ownership group for the purposes of the 80% test and the 50% test. Contrary to the regulation adopted, all of the examples furnished by the Treasury to the Congress illustrating the 1969 amendment to Section 1563 included the requirement of common ownership in each corporation.

The Treasury's interpretation of Section 1563(a)(2) results in the onerous and implausible result of subjecting an expanded group of minority shareholders in corporations to the possibility of deprivation of tax benefits otherwise available without their prior knowledge or participation. This is clearly inconsistent with the intent of Congress. Moreover, accepting the Treasury's position allows an unfair and unexpected result that the Treasury may present one view of legislation to Congress prior to enactment and adopt another view after enactment, thereby expanding and changing the statute adopted by Congress. Such a result is a "gross usurpation of the power of Congress." *Vogel Fertilizer Company v. United States,* 434 F.2d 497, 508 (Ct.Cl. 1980) (Pet. App. 25a).

ARGUMENT

THE TREASURY'S DEFINITION OF A BROTHER-SISTER CONTROLLED GROUP OF CORPORATIONS SET FORTH IN TREAS. REG. §1.1563-1(a)(3) IS AN IMPROPER AND UNREASONABLE INTERPRETATION OF THE LANGUAGE OF THE STATUTE.

From the first moment of its promulgation and continuing into the present, Treas. Reg. §1.1563-1(a)(3) (1969) (sometimes referred to as "Regulation") has met with a storm of criticism from academics and members of the tax bar.[4] The almost unanimous reaction of those persons experienced with the background and development of the 1969 amendment of Section 1563(a)(2) has been that the Treasury's interpretation of the 80% test was unreasonable and improper. As a general rule, the Court does not overturn "contemporaneous constructions by those charged with administration of" the Internal Revenue Code, most often applying a rule of deference which

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[4] *See* Bonovitz, *Brother-Sister Controlled Groups Under Section 1563: The 80 Percent Ownership Test*, 28 TAX LAWYER 511 (1975); Pearlman, *Recasting the Multiple Corporate Group After the Multiple Surtax Exemption Ends*, 41 J. TAXATION 194 (1974); Thomas, *Brother-Sister Multiple Corporations The Tax Reform Act of 1969 Reformed by Regulation*, 28 TAX L. REV. 65 (1972); Kringel, *Multiple Corporation Proposed Regulations Raise More Questions Than They Answer*, 36 J. TAXATION 353 (1972); Libin & Abramowitz, *Multiple Corporations: A Surprising Interpretation of Sec. 1563(a)(2) and Temporary Regulations*, 3 TAX ADVISOR 326 (1971). *See also* Note, *Disallowance of Surtax Exemption to Brother-Sister Corporation Stock Ownership Test Under Sections 1551 and 1563*, 1976 BRIGHAM YOUNG L. REV. 1000, 1017; Weisman, *Brother-Sister Controlled Corporations: On and Off the Road To the Supreme Court With and Edsel*, 1978 TAXES 475. *But see* White, *The Tax Reform Act of 1969, Demise of Multiple Surtax Exemptions – When Too Much of a Good Thing Proved Its Own Undoing*, 16 WAYNE L. REV. 1353 (1970).

places a heavy burden on the taxpayer who seeks to challenge the Commissioner's interpretation of a statute. *Commissioner v. South Texas Lumber Co.*, 333 U.S. 496, 501 (1948). This normal rule of deference which was most recently stated by the Court this term in *Commissioner v. Portland Cement Co. of Utah*, ___ U.S. ___, 101 S.Ct. 1037, 1045 (1981) defers to Treasury Regulations that implement the congressional mandate in some reasonable manner." *United States v. Correll*, 389 U.S. 299, 307 (1967); *See also United States v. Cartwright*, 411 U.S. 546, 550 (1973); *Fulman v. United States*, 434 U.S. 528, 533 (1978); *National Muffler Dealers Assn. v. United States*, 440 U.S. 472, 476-77 (1979); *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522, 533 n.11 (1979). Notwithstanding the rule of deference, however, "weighty reasons" for invalidating a regulation exist when a regulation achieves a result which is unreasonable and inconsistent with the express language of the statute, or which is not supported by the statute's legislative history. *United States v. Cartwright, supra* 411 U.S. at 550; *National Muffler Dealers Assn., Inc. v. United States, supra* 440 U.S. at 476-477. As will be discussed in this brief, "weighty reasons" exist for the Court not to defer to the Treasury's expansive and unreasonable interpretation of Section 1563 which was adopted in Treas. Reg. §1.1563-1(a)(3) (1969).

In the case of Section 1563(a)(2) there is sufficient reason to require a strict construction of the language of the statute and not to apply the normal presumption in favor of a Treasury regulation. As recognized by the Court of Claims, the rule of deference is not appropriate when the Treasury is providing a definition to fit the statute, and the sole issue is whether persons in the position of the taxpayers are covered by the statute. (Pet.

App. 33a). The Commissioner has no power to add to the Internal Revenue Code that which he may believe Congress overlooked or deliberately omitted. *See e.g. Helvering v. Credit Alliance Corp.*, 316 U.S. 107, 113 (1942). Since Section 1563(a)(2) is definitional, it should not be applied beyond a narrow application without specific congressional approval. That is, the underlying effect of Section 1563 was to replace a subjective test of common ownership with an objective test. To the extent the Treasury is allowed to impose an expansive interpretation upon the taxpayer, it changes the original definition adopted by Congress.[5] The Court of Claims in addressing this issue noted that it would be "inappropriate for the application of the principle of deference in this case where [the] sole question here is whether the 80-percent provision requires that the five or fewer persons involved each hold stock in all of the brother-sister corporations. The answer to that question turns [in this case] upon the statutory language, the legislative history, and the basic purpose and design of the legislation." (Pet. App. 33a).

The distinction between a definitional statutory provision which involves a mathematical test rather than a statute which involves an interpretational function by the Treasury is critical to an application of the rule of deference by the Court in this case. In this respect, Section 1563(a) differs from Section 611, which was the subject of the Court's decision in *Commissioner v. Portland Cement Co. of Utah, supra,* and unlike that case

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[5]Prior to enactment of Section 1563 in 1964, Sections 269, 482 and 1551 were the Internal Revenue Service's sole vehicles for attacking the use of multiple corporations to achieve tax benefits. Each of these sections required a showing of an improper tax motive in the use of more than one corporation.

does *not* involve a specific delegation to the Commissioner to define by regulation the controlled group of stockholders. Similarly, the Regulation does not involve an instance of the Treasury supplying definitions which were otherwise omitted by Congress but necessary to interpret the statutes as for example in *Bingler v. Johnson,* 394 U.S. 741 (1969); or a statute which on its face "vest(s) the Commissioner with wide discretion" in order to determine the stock ownership requirements which are themselves the threshold requirements of the statute. *Thor Power Tool Co. v. Commissioner, supra,* 439 U.S. 522, 533 (1979). The test of stock ownership imposed by Congress is a clear and unambiguous objective line drawing to replace a previous subjective test. The objective test is satisfied when the threshold requirement is met that a person own stock in each of the corporations involved before applying either the 80% or 50% test. As noted by the Fifth Circuit, the court, "particularly in the area of federal taxation, . . . should not ignore percentage requirements obviously and specifically fixed by Congress." *Delta Metalforming, Inc. v. Commissioner, supra,* 632 F.2d at 450.

A reading of the language of Section 1563(a)(2) does not justify the Treasury's expansive interpretation of the statute. In *Fairfax Auto Parts of Northern Virginia, Inc. v. Commissioner,* 65 T.C. 798 (1976), *rev'd and remanded,* 548 F.2d 501 (4th Cir. 1977), the Tax Court analyzed the language of Section 1563(a)(2) and concluded that the Treasury's addition in the Regulation was an "unwarranted extension of the statutory language of Section 1563(a)(2)." Similarly, as concluded by the Court of Claims, and the Fifth Circuit in *Delta Metalforming Co., Inc., supra,* the plain meaning of the language of the statute cannot and does not support the

Treasury's interpretation as set forth by it in Treas. Reg. §1.1563-1(a)(3). Nowhere in the statute is there included the words "singly or in combination thereof."

The term "controlled group of corporations" is defined in Section 1563(a)(2) to mean a "brother-sister" controlled group of corporations with the significant words of the statute being:

> (2) . . . Two or more corporations if *5 or fewer persons* . . . own . . .
>
> (A) at least 80 percent of the stock of each corporation, *and*
>
> (B) more than 50 percent of the stock of each corporation, taking into account the stock ownership of *each such person* only to the extent such stock ownership is identical with respect to each such corporation. (Emphasis added).

Contrary to the language of the statute emphasized herein, the Petitioner (Pet. Brief at 20) has sought to highlight only the identical ownership requirement in the 50% test. Such a reading ignores the proper thrust of the language of the statute, by overlooking the importance that the words "5 or fewer persons" are the subject of both the 80% and 50% test. Further the two tests are conjunctive, and the terms "each such person" in the 50% test refer directly back to the antecedent "5 or fewer persons." In construing the meaning of the statute, the Fifth Circuit in *Delta Metalforming Co., Inc., supra* 632 F.2d at 446, found that "[s]ince the same words apply to both tests, and the tests are characterized by sibling kinship, it would then make sense that the very same five or fewer persons should satisfy both tests. Further, the 50% test uses the language 'each such person' in describing the nature of the group. The grammatical antecedent for 'each such person' is 'five or fewer per-

sons.' Since the phrase 'five or fewer persons' is the antecedent for the 80% test as well as the 50% test, it is reasonable to conclude that 'each such person' in the second test would also apply to the first."

Contrary to Petitioner's view and that of the Second Circuit in *Allen Oil Co. v. Commissioner,* 614 F.2d 336, 339 (1980), the Court of Claims reading of the plain meaning of the statute does not "seriously weaken" the overlapping ownership required by the 80% test and the identical ownership required by the 50% test. As explained by the Court of Claims, the requirement that a person own stock in each of the corporations as a precondition of inclusion in the 80% test "merely requires the same persons to be in the group of controlling stockholders used in both tests." (Pet. App. 10a-11a). This view (as will be further discussed *infra* at 15) is consistent with the functions intended for each test. Moreover, the continued value of the 80% test itself is eliminated as a meaningful test if the Treasury's interpretation is applied. As pointed out by the Fifth Circuit, "[a]s we see it, the 80% ownership requirement in conjunction with the 50% identical ownership requirement work best in tandem. Each has a significant correspondent purpose and the stockholding requirements should be interpreted to ascribe to each a function that renders neither superfluous, dominant, or subordinate." *Delta Metalforming Co., Inc. v. Commissioner, supra* 632 F.2d at 450.

A reading of the plain language of the statute does not support the Treasury's regulation. Notwithstanding the strength of this conclusion, assuming *arguendo* that there is an ambiguity in Section 1563 (albeit tortuous), this factor does not in and of itself justify a conclusion that deference by the Court should be given to the interpre-

tation adopted by the Commissioner of Internal Revenue because there is some *possibility* that a rational relationship exists between the language of the statute and the regulation. When read in the context of the legislative purpose the statute was intended to serve, the Treasury's interpretation of Section 1563 is unreasonable and inconsistent with the statute.

In the case of a statute which may be subject to more than one interpretation, the Commissioner cannot select an interpretation which, though not plainly inconsistent on its face with the underlying statute, is unrealistic in light of Congress' intent, or fails to implement the congressional mandate in a reasonable manner. *United States v. Cartwright, supra* 411 U.S. at 550; *National Muffler Dealers Assn., Inc. v. United States, supra* 440 U.S. at 476-477; *Delta Metalforming Co., Inc. v. Commissioner, supra* 632 F.2d at 449, *petition for cert. pending,* No. 80-1499 (filed Mar. 4, 1981). If the validity of Treas. Reg. §1.1563-1(a)(3) cannot be finally determined from a reading of the plain meaning of the language of Section 1563(a)(2), the regulation must be measured against the legislative history of the statute; and if it prescribes a result which is not consistent with that which Congress intended, then the regulation must be declared invalid.

The most recent example of the Court's unwillingness to apply the rule of deference to a Treasury regulation occurred this term in *Rowan Companies, Inc. v. United States,* ___ U.S. ___ , 101 S.Ct. 2288 (1981). In that case, the Court overturned the Treasury's regulation interpreting the definition of "wages" in FICA and FUTA for failing to implement the statutory definition in a consistent or reasonable manner, finding that the plain meaning and legislative history of the statute did not support the Treasury's interpretation. As in that

case, Congress in adopting Section 1563(a) specifically set forth the percentage and common ownership requirements necessary for triggering the 80% test and the 50% test. Because the definition is set forth by Congress in the statute, the Treasury's interpretation is owed "less deference than a regulation issued under a specific grant of authority to define a statutory term or prescribe a statutory provision." *Rowan Companies, Inc. v. United States, supra* at 2292.[6] It is after an examination of the legislative history, origin and purpose of Section 1563-(a)(2) pertaining to the 80% test and 50% test that any ambiguity in the plain meaning of the statute is clearly resolved against the Treasury's expanded definition of the stock ownership required to bring taxpayers into the ambit of what Congress originally intended brother-sister controlled corporations to be.

TREAS. REG. §1.1563-1(a)(3) IS INVALID BECAUSE IT PRESCRIBES A RESULT WHICH IS NOT CONSISTENT WITH THE LEGISLATIVE HISTORY AND THE PURPOSE OF SECTION 1563(a)(2).

A. As A Result Of The Treasury's Misconstruction Of Section 1563(a)(2), The 80% Test And The 50% Test Are Being Used In A Way That Was Never Intended By Congress.

Prior to the amendment of Section 1563(a)(2) in 1969, the definition of a brother-sister controlled group

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[6]One important factor in *Rowan Companies, Inc. v. United States, supra,* involved the Treasury's inconsistent interpretation of the term "wages" under regulations first adopted in 1936 and later changed by the Treasury in 1940. Similarly, in the present case, the Treasury's inconsistency in interpreting the statute is evidenced by the different interpretation and examples offered to Congress prior to adoption of the 1969 amendment to Section 1563(a) when compared with the regulation adopted after enactment.

was limited to situations where 80% of the ownership of each of two or more corporations was vested in one person. Section 1563(a)(2) as it read before the Tax Reform Act of 1969 provided that a brother-sister group existed where an individual, estate or trust owned at least 80% of the voting power or value of the stock of two or more corporations. 26 U.S.C. §1563(a)(2), P.L. 88-272, 78 Stat. 25 (1964). In order to broaden the application of 1563(a)(2) to include corporations which operated as one economic entity, the amendment increased the number of shareholders that could be considered in determining if the requisite common control was present from one to five.

The Treasury's key addition to the statutory language in Treas. Reg. §1.1563-1(a)(3) is the provision that the stock ownership of the same five or fewer persons should be considered "singly or in combination." As appears from Example 1 of the Regulation,[7] the language removes the common ownership requirement from the 80% test and permits a person to be treated as one of the five or fewer persons comprising the group of controlling shareholders even though such person holds stock only in one corporation.

The effect of the Regulation is to make the 50% test the primary test and to relegate the 80% test to a minor role. (Pet. App. 23a). *Delta Metalforming Co., Inc. v. Commissioner, supra* 632 F.2d at 450; *T.L. Hunt, Inc., v. Commissioner, supra* 562 F.2d at 536 (Webster, J., dissenting). This follows because, if the 50% test is satisfied by one person who owns more than 50% of the stock in each corporation, the 80% test may be satisfied by any combination of four or fewer shareholders who in the aggregate own 30% of the stock in each corporation but

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[7] Ex. 1 of Reg. §1.1563-1(a)(3)(ii).

who individually may own stock in only one of the corporations in the group. There is little gained by including minority shareholders who have no common financial interests with one another in a controlled group simply because in the aggregate they own 30% of the stock in two or more corporations. Bonovitz, *Brother-Sister Controlled Groups Under Section 1963: The 80 Percent Ownership Test,* 28 TAX LAWYER 511 (1975). In the opinion of one commentator: "To interpret the statute so that the 80% test can be met by persons having ownership in only one corporation ignores the obvious relationship between the 50% test and the 80% test, *i.e.*, the exercise of control by persons with a substantial financial interest in the corporations . . . The features which make several corporations similar to one corporation is the exercise of control by a few persons over several corporations to further the substantial financial interest of *these* persons in *all* such corporations. If the statute is to test for the pattern of ownership where this feature will be present, then it must be interpreted to require that only the stock of persons with at least some stock in each corporation be counted in meeting the 80% test." Thomas, *Brother-Sister Multiple Corporations — The Tax Reform Act of 1969 Reformed by Regulation,* TAX L. REV. 65, 83 (1972). (Emphasis supplied).

The legislative history to the 1969 amendment of Section 1563(a)(2) clearly indicates that a meaningful independent role was intended for the 80% test of Section 1563(a)(2)(A) which, consistent with its use in the predecessor provisions to Section 1563(a)(2), was designed to be a measure of the common financial interest of shareholders comprising the alleged controlled group. The only significant legislative material on the 1969 change is the Treasury Department's General and Technical Explanations of its proposals which confirm that the 80% test was intended to be meaningful, and that

the 50% test was created as a limitation on the 80% test in certain situations.[8]

The Treasury's General Explanation demonstrates that the purpose of the 1969 amendment was to increase the number of shareholders that could comprise the controlled group from one to five. It did not change the prior existing stock ownership pattern. In addition, the "50 percent control test" was to insure that such common

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[8]The pertinent sections of the Treasury's General Explanation provide:

> (2) *Brother-sister groups.* — A group of corporations in which five or fewer persons own, to a large extent in identical proportions, at least 80 percent of the stock of each of the corporations. This provision expands present law by considering the combined stock ownership of five individuals rather than one individual, in applying the 80-percent test. Even the mild 6-percent penalty under existing law for brother-sister corporations claiming multiple surtax exemptions is largely ineffectual because of the present requirement that one person own 80 percent of the stock of each corporation before the group is subject to the penalty.
>
> However, in order to insure that this expanded definition of brother-sister controlled group applies only to those cases where the five or fewer individuals hold their 80 percent in a way which allows them to operate the corporations as one economic entity, the proposal would add an additional rule that the ownership of the five or fewer individuals must constitute more than 50 percent of the stock of each corporation considering, in this test of ownership, stock of a particular person only to the extent that it is owned identically with respect to each corporation.
>
> Thus, even where the 80 percent ownership test is met, the brother-sister definition will not apply unless the stockholdings of the individuals in the various corporations also meet the 50-percent identical ownership test. (Footnote omitted).

GENERAL EXPLANATION OF TREASURY TAX REFORM PROPOSALS IN HEARINGS ON THE SUBJECT OF TAX REFORM BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS, 91st Cong., 1st Sess., Pt. 14, at 5394 (1969) (sometimes referred to as "General Explanation").

stock ownership is for the most part ("to a large extent") *identical.* Moreover, as noted by the Court of Claims, if the significant change in the statute was intended to have been "removal of the requirement in the prior version of the 80-percent test that each shareholder must own some stock in each corporation," rather than the expansion of the number of stockholders considered from one to five, the Treasury's Explanation would have said much more when it stated the amendment's purpose. (Pet. App. 22a). The correctness of this interpretation is confirmed by the fact that in every example offered by the Treasury in its explanation involving the 80% test, the *persons* mentioned in each example *own* some *stock* in *each* corporation.

Petitioner's argument regarding the General Explanation (Pet. Brief 29) is at best strained. It attempts to read the language of the General Explanation without reconciling its interpretation with the remaining text or with the origin of the statute. Moreover, it glosses over the fact that the expansion which the Treasury seeks of the stock ownership in the 80% test is not addressed or supported in the text nor supported by Treasury's own examples. Further, the General Explanation is "totally inconsistent with the relatively minor role relegated to the 80-percent test by Treas. Reg. §1.-1563-1(a)(3)."[9] (Pet. App. 23a.)

The Treasury Technical Explanation is further compelling evidence that the same persons were expected to comprise the ownership group for purposes of the

[9]The General Explanation states: "Thus, even where the 80 percent ownership test is met, the brother-sister definition will not apply unless the stockholdings of the individuals in the various corporations also meet the 50-percent identical ownership test." The emphasis of the sentence on the 80-percent test as the primary requirement belies the notion that the 80-percent test was intended to measure only the number of stockholders and not the extent of overlapping stock ownership.

80% test and the 50% test. The pertinent part of the Technical Explanation stated:

> "Brother-sister controlled group. *Present law* defines a brother-sister controlled group as a group of corporations in which the voting stock or value of shares of each member is owned 80 percent by the same person (i.e. individual, estate or trust). Under the proposal, the present definition would be changed so that a group of corporations would constitute a brother-sister controlled group if (1) *the same five or fewer persons,* own at least 80 percent of the voting stock or value of shares of *each* corporation, *and* (2) *these five or fewer individuals* own more than 50 percent of the voting power or value of shares of each corporation considering a particular person's stock only to the extent that it is owned identically with respect to each corporation."

TECHNICAL EXPLANATION OF TREASURY TAX REFORM PROPOSALS ON HEARINGS ON THE SUBJECT OF TAX REFORM BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS, 91st Cong. 1st Sess., Pt. 14 at 5168 (sometimes referred to as "Technical Explanation"). (Emphasis added). There is no indication in the legislative history that the amendment was intended to relax the requirement of common ownership or "sameness" contained in prior Section 1563(a)(2), and in the regulations to Section 1551. As was the case with the General Explanation, there are no examples in the Technical Explanation which do not include common ownership by the persons included in the 80% test in each corporation.

Petitioner's reading of the above language (Pet. Brief 30-31) is plainly incorrect in that the Technical Explanation nowhere refers to the same *group* of five or fewer persons. The explanation clearly provides that the 80% test is satisfied if the same five or fewer *persons* own at least 80% of the stock of *each* corporation *and* that these

same five or *fewer individuals* also satisfy the 50% test. Both the Court of Claims in this case and the Fifth Circuit in *Delta Metalforming Co. v. Commissioner* agreed with this reading of the Technical Explanation which supports the logical conclusion "[t]hese very same five or fewer persons – only one combination with the same members – [constitute] one economic entity – [and] must comprise the asserted control group." *Delta Metalforming Co., Inc. v. Commissioner, supra* 632 F.2d at 448.

The Treasury General and Technical Explanations make clear that the vehicle for insuring that the requisite common ownership is present is the 80% test, and that the 50% test was designed to limit the application of the 80% test to situations where the common stock of the two or more corporations is held in vastly differing proportions. As described above, if Treas. Reg. §1.1563-1(a)(3) is valid, the 80% test would be rendered secondary, and the required overlap of ownership would be reduced from 80% to 50%. Congress nowhere indicated an intention to achieve this result.

The Tax Court in *Fairfax Auto Parts* discussed the expansion of the ownership group in the 1969 amendment to Section 1563(a)(2) and its relation to the requirement of common control and came to the conclusion that

> ". . . *it is obvious to us that a shareholder must be denied admission to the ownership group absent stock ownership in every member of the controlled group.* A contrary interpretation of Section 1563-(a)(2) would simply do violence to the statutory language and legislative history thereof. (Emphasis added).

Fairfax Auto Parts, supra 65 T.C. at 804-805. (Emphasis added.)

An identical trumpet was sounded by Judge Webster in his dissent in *T.L. Hunt, Inc.* when he wrote: "It is not the *smallness* of the number of persons in each company that triggers §1563; it is the *sameness* of that small number. The 80 percent financial interest requirement is meaningless unless it is the *same* group of five or fewer persons that own 80 percent of each company within the controlled group. It is this requirement of economic entity which is entirely eviscerated by Reg. §1-1563-1(a)(3)." *T.L. Hunt, Inc. v. Commissioner, supra* 562 F.2d at 537. (Webster, J., dissenting). (Emphasis not added).

This theme was reiterated by the Court of Claims in this case[10] and by the Fifth Circuit in *Delta Metalforming Co., Inc. v. Commissioner,* where both courts concluded that there was no intention on the part of Congress in amending Section 1563(a)(2) to abolish the requirement of 80% common ownership among corporations in a brother-sister controlled group. Following different paths, the courts that have invalidated Treas. Reg. §1.1563-1(a)(3) have arrived at the same conclusion: that Congress never intended to eliminate the requirements of sameness and common ownership among the persons constituting the ownership group of each corporation alleged to be a member of a brother-sister controlled group, and that Regulation §1.1563-1(a)(3) insofar as it would abolish the requirement of common ownership in the 80% test of Section 1563(a)(2)(A), is invalid. As emphasized by the Court of Claims after reviewing the legislative history evidenced by the Treasury's own explanation presented to Congress of the 1969 amendment, "we fail to understand how this document has been construed as supporting, or at least not contra-

[10]Pet. App. 21a-24a.

dicting, the interpretation of Section 1563(a)(2) made by Treas. Reg. §1.1563-1(a)(3)." (Pet. App. 20a-21a).

B. Treas. Reg. §1.1563-1(a)(3) Is Invalid In That Congress Did Not Intend To Place Minority Shareholders In A Situation Where They Could Be Deprived Of Tax Benefits Without Their Knowledge Or Participation.

Under Treas. Reg. §1.1563-1(a)(3) it is possible for a shareholder who owns more than 50% of the stock in a corporation to involve his co-shareholder in a controlled group without the co-shareholder's knowledge or participation. This follows from the fact that, under the Regulation, a person may be considered part of the ownership group of a controlled brother-sister group even though he does not own stock in each member of the controlled group. There is no indication in the legislative history that Congress ever intended to permit the Commissioner to lay a trap for an expanded group of unknowing minority shareholders. In *Fairfax Auto Parts of Northern Virginia, Inc., supra* 65 T.C. at 805, n.5 the Tax Court stated: "Individual A owns 55 percent of corporation X and individual B owns 45 percent thereof. If A were independently to enter into a second business in corporate form the corporations would be component members of a controlled group. *We cannot believe that Congress intended to surprise B with such a result.* We recognize that had A owned 80 percent of corporation X and B 20 percent thereof, the corporations would constitute a controlled group. However in the latter instance, B's unfortunate surprise would be necessitated by both the mechanical application of the stock ownership tests and the respective functions of the 80 percent and 50 percent tests . . ." (Emphasis added).

As asserted by the Petitioner (Pet. Brief 24) as well as by Judge Simpson in his dissent in *Fairfax Auto Parts of Northern Virginia, Inc., supra,* Respondent's interpretation of the statute would place great weight upon the ownership of one share of stock. *Fairfax Auto Parts of Northern Virginia, Inc. v. Commissioner, supra,* 65 T.C. at 812. In answer to the argument that the ownership of a single share of stock should not determine the existence of a controlled group, the Fifth Circuit responded that "stock ownership – or lack of ownership – or even a single share entails significant rights, opportunities and disabilities. The shareholder may vote to elect and remove directors, adopt, amend and repeal bylaws, adopt resolutions, affect extraordinary corporate matters, and see corporate books and records . . . He also has standing to bring suit against an officer or director of the corporation who breaches his fiduciary duties to the entity, or under the Securities Act of 1934." *Delta Metalforming Co., Inc. v. Commisssioner, supra* 632 F.2d at 450.

In any event, the rights of a holder of even one share of stock would provide him with sufficient notice that he may own stock in a corporation which is in a controlled group, thereby preventing the harsh surprise which is possible under Treas. Reg. §1.1563-1(a)(3). However, it is implausible that the expanded group of individuals who did not own *any* stock whatsoever in such corporation was intended by Congress to be "unknowingly" subjected to the imposition of Section 1563(a)(2) without the Congress specifically considering the impact of such an interpretation. What in fact the Petitioner is arguing against is that the objective standards established in Section 1563 which were narrowly drawn and operate in an arbitrary fashion. In this respect, the Treasury's interpretation of the statute in Treas. Reg. §1.1563-1(a)(3) goes beyond the acceptable bounds of even the

recognized "line drawing" of Congress.[11] Moreover, because the test imposed by Section 1563 is objective and involves the application of an arbitrary "line drawing," the common stock ownership in each corporation by the persons in the group must be considered a threshold criteria for application of the statute in order to limit the unfair "surprise" which the Treasury's interpretation would impose on an expanded group of minority shareholders.

C. Where The Treasury, As Part Of Its Proposals To Congress Encouraged Congress To Rely On An Interpretation Of Section 1563(a)(2) Which Was Not Consistent With The Treasury's Position Taken In Treas. Reg. §1.1563-1(a)(3), Treas. Reg. §1.1563-1(a)(3) Must As A Matter Of Law Be Inconsistent With The Congressional Purpose.

As discussed hereinbefore (*supra* at 17), the Treasury in several ways explained to the Congress that the 80% common ownership test was being preserved in the amendment to Section 1563(a)(2) and that the purpose of the 50% test was to limit the 80% test, rather than to supplant it, as the sole test of common ownership. Every example submitted by the Treasury in its explanation to the Congress involved only shareholders who owned stock in each of the member corporations. General Ex-

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[11] This is apparent from the Petitioner's attempt to minimize the Court of Claims' discussion pertaining to the "predictable actions of real taxpayers" when considering the motives for a person to make a token investment of stock only to *increase* taxes rather than to *avoid* them. (Pet. Br. 26, n.4) Contrary to Petitioner's view, it is "minute distinctions" such as the ownership of a single share of stock which triggers the application of Section 1563.

planation, *supra* at 5394-96; Technical Explanation, *supra* at 5168-70. This fact is compelling support for the Court of Claims' interpretation of the underlying meaning and purpose of the legislative history of the amendment. Moreover, the fact that the examples presented by the Treasury failed to include a single case illustrating this fundamental issue regarding the 80% test undermines support for its interpretation in Treas. Reg. §1.1563-1(a)(3). In this respect the argument that the Treasury cannot be called upon to present Congress with an exhaustive explanation of every application of an act is of little merit. First, as hereinbefore discussed, the statute itself imposes a mathematical definition making application of the percentage of stock ownership involved critical to implementation of the statute. Second, the examples submitted by the Treasury involved far more complicated patterns of ownership than the basic issue of whether or not stock ownership was a requirement for application of the 80% test. In this respect, the Treasury's General Explanation of the 1969 amendments cites one case in which the parent corporation had 516 wholly-owned subsidiaries all in the same controlled group. General Explanation, *supra* at 5388. Further, the General Explanation also refers to a 1963 Treasury survey of 55 large corporate groups, each of which averages 115 separate corporations. General Explanation, *supra* at 5391.

It is internally inconsistent for the Government to argue that Treas. Reg. §1.1563-1(a)(3) is in accord with the congressional purpose, or that Congress has implicitly adopted Treas. Reg. §1.1563-1(a)(3), when the position taken by Treasury prior to enactment of amended Section 1563(a)(2) deprived Congress of the opportunity to consider the impact of the position taken by Treasury in adopting the Regulation. In addressing this issue of

unfairness, the Court of Claims noted that: "It would be a gross usurpation of the power of Congress to draft tax statutes to allow the Treasury to explain a legislative proposal in one way and then to interpret it after enactment in a far more expansive fashion." (Pet. App. 24a).

Furthermore, Petitioner's discussion (Pet. Brief 31-33) of Section 1551(b)(2) does not rescue the strained legislative interpretation it asserts to be found in Section 1563, nor resolve the fact that an examination of the language of Section 1551(b)(2), the legislative history thereunder and the pertinent regulations all support the logical conclusion that each of the stockholders own stock in each corporation. The Treasury expressly represented to Congress that the stock ownership test of Section 1563(a)(2) would be the same as the test employed in Section 1551(b)(2). General Explanation, *supra* at 5394. Petitioner's reliance on an at best arguable *inference* drawn from a single Treasury Regulation under Section 1551(b)(2) to support its addition of the words "singly or in combination" in Section 1563(a)(2) is unconvincing. As recognized by the Court of Claims (Pet. App. 26a) "any implied congressional approval must necessarily be limited to the literal wording of the regulations and cannot be extended to a possible inference or interpretation." *Montana Power Co. v. United States,* 232 F.2d 541, 549 (3d Cir.), *cert. denied,* 352 U.S. 843 (1956). The point is that neither Section 1551 nor any of the Treasury regulations thereunder include the words "singly or in combination." The best the Treasury can do is claim support for their interpretation in Treas. Reg. §1.1551-1(g)(4), Example 4. However, when closely examined, that example in the context of both the legislative history of Section 1551(b)(2)and the other exam-

ples[12] in the regulations under Section 1551 supports a conclusion that the ambiguity between the conflicting regulations is resolved by concluding that common ownership by each stockholder is required. (Pet. App. 26a-28(a)). See, Bonovitz, *supra*, 28 TAX LAWYER at 519-530. As noted by both the Court of Claims (Pet. App. 27a) and the Fifth Circuit in *Delta Metalforming Co., Inc. v. Commissioner, supra* 632 F.2d at 450-451, Example 4 cited by Petitioner can be further distinguished because "the example merely illustrates that a transfer can be made by one, rather than all, of the individuals in control of the transferor corporation or that the controlling stockholders of the transferee corporation must come from the group of five or fewer shareholders of the transferor but need not include all of the members of that group." (Pet. App. 27a). Petitioner's interpretation of support under Section 1551 for the Treasury's position is at best based only on an ambiguous example. In contrast to this view, it is logical that if Congress intended to adopt the expansive view subsequently promulgated by the Treasury in Treas. Reg. §1.1563-1(a)(3), it would have specifically addressed the question at the time of congressional enactment.

Similarly, Petitioner's attempt to gain support from application of the theory of legislative re-enactment illustrates the weakness of its position. As a general rule and as acknowledged by the Court of Claims in this case "[r]e-enactment – particularly without the slightest

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[12]Treas. Reg. §1.1551-1(f)(2) ex. 2 can be interpreted as supportive of the taxpayer's position, while Treas. Reg. §1.1551-1(g)(4) ex. 4 seems to indicate that the 'ownership of a person could be taken into consideration for purposes of the 80% test even though the taxpayer did not own stock in some of the corporations and was therefore not considered for the purposes of the 50% test.' 65 T.C. at 807.

affirmative indication that Congress ever had before it the particular construction in question – is unreliable indicium at best." (Pet. App. 24b) *citing Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955). In this respect the fact that Section 1015 of the Employee Retirement Income Security Act of 1974 (ERISA), Pub.L. No. 93-406, 88 Stat. 925 added Section 414(b) of the Internal Revenue which incorporated the control test of Section 1563(a) at a time when the regulations thereunder were issued does not support the view that it was the Congress' intention to readopt Treas. Reg. §1.-1563-1(a)(3). First, there is no specific mention of the fact that Congress affirmatively addressed the regulation. Second, as noted by the Court of Claims "[b]ecause of the short periods between the publication of each regulation under Section 1551(b)(2) and 29 months in the case of Treas. Reg. §1.1563-1(a)(3)), congressional approval of the regulations cannot be implied." (Pet. App. 25a). The Court has in the past refused to give any significance to the re-enactment of a provision as part of the Internal Revenue Code without some affirmative indication that Congress has considered the question for example where only 3 years elapsed after the initial regulation in question. *United States v. Calamaro*, 354 U.S. 351, 358-59 (1957). *Accord, Commissioner v. Sun Pipe Line Co.*, 126 F.2d 888, 892 (3d Cir. 1942); *Commissioner v. F.H.E. Oil Co.*, 102 F.2d 596, 598 (5th Cir. 1939), *aff'd*, 308 U.S. 104 (1939).[13]

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[13]There is similarly little merit to Petitioner's attempt (Pet. Brief 34, n.7) to bootstrap the fact that the American Bar Association's Tax Section 1974 recommended amendment to Section 1563(a) (Tax Section Recommendation No. 1974-1 (A.B.A.), 27 TAX LAWYER 813, 817 (1974)) was never enacted into law. In this respect, there is little to indicate the full Congress' con-

[footnote continued]

CONCLUSION

For the reasons stated, Dixie Realty Company, Inc. and Dixie Furniture Co., Inc., as *amici curiae*, respectfully urge that the judgment of the United States Court of Claims be affirmed.

Respectfully submitted,

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July 31, 1981

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sideration of the matter and its affirmative discussion not to change the statute. Rather than reliance upon an extremely unreliable theory attempting to glean some meaning from Congress' failure to adopt a specific legislative proposal, the underlying purpose of the ABA amendment better stands for the fact that the Treasury Regulation under review in this case was viewed as an improper and unreasonable interpretation by the Treasury of Section 1563(a)(2).